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E.O. 11652: N/A

TAGS: EFIN, GW

SUBJECT: INFLATION: IS THE SITUATION BETTER OR WORSE?

REF: BONN 11999

SUMMARY: THE ANSWER TO THE QUESTION POSED IN THE SUBJECT LINE IS THAT IT DEPENDS ON WHICH STATISTICS ONE FOCUSES. THE YEAR-OVER-YEAR COMPARISON OF NON-SEASONALLY ADJUSTED INDEX NUMBERS REFLECTS A MODERATING TREND FOR CONSUMER PRICES, RELATIVELY LOW RATES FOR INDUSTRIAL PRICES, AND RATHER HIGH IMPORT PRICE RISES. HOWEVER, THE MORE MEANINGFUL MEASURE OF CURRENT TRENDS, COMPARISON OF SEASONALLY ADJUSTED DATA FOR THE CURRENT PERIOD WITH THAT IMMEDIATELY PRECEDING PORTRAYS A DIRECTLY REVERSE VIEW OF DEVELOPMENTS. INSTEAD OF THE 4.5 PERCENT YEAR-OVER-YEAR INFLATION RATE MOST OFTEN HEARD, THE ADJUSTED RATE (S.A.A.R.) IS CURRENTLY RUNNING 6 - 7 PERCENT. IMPORT PRICES ARE SHARPLY DROPPING, BUT INDUSTRIAL PRICE RISES ARE SUBSTANTIAL. DESPITE THE CURRENT ACCELERATION OF INFLATION, THE GENERAL PUBLIC PERCEPTION OF THE PROBLEM LAGS AND IS THEREFORE ONE OF DAMPENED INFLATIONARY EXPECTATIONS, A HELPFUL FEATURE IN AN ELECTION YEAR. HOWEVER, INFORMED LABOR OBSERVERS ARE BEGINNING TO VOICE THEIR CONCERN. END SUMMARY

1. GERMAN PUBLIC PERCEPTION IS THAT,HOVERALL, INFLATION IS MODERATING. WHERE PRICE PRESSURES DO EXIST, THEY ARE COMMONLY THOUGHT TO STEM FROM RISING PRICES FOR IMPORTED GOODS WITH A MODERATE RISE IN INDUSTRIAL PRICES BEING ONLY A MINOR FACTOR. THESE ASSUMPTIONS ARE LARGELY BASED ON THE READING OF NON-SEASONALLY ADJUSTED STATISTICS, COMPARING THE INDEX NUMBER FOR A GIVEN MONTH THIS YEAR WITH THAT OF THE SAME MONTH LAST YEAR TO OBTAIN A YEAR-OVER-YEAR GROWTH RATE. IT IS THIS ANALYTICAL APPROACH THAT ONE READS MOST COMMONLY IN GOVERNMENT PRESS RELEASES AND EVENTUALLY IN THE PRESS ITSELF. INFLATIONARY EXPECTATIONS ARE NOT, AS A RESULT, VERY GREAT.H THE GOVERNMENT SPEAKS OF A 5 PERCENT INCREASE IN CONSUMER PRICES IN 1976, AND THIS IS GENERALLY ACCEPTED. FOLLOWING ON 7 PERCENT AND 6 PERCENT INCREASES LIMITED OFFICIAL USE

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IN 1974 AND 1975, RESPECTIVELY, FEARS OF WORSENING INFLATION ARE NOT THEREFORE WIDESPREAD. THE BUNDESBANK AND GOVERNMENT WARN OF THE DANGER, BUT TOO HEAVY EMPHASIS IN THIS ELECTION YEAR HAS BEEN AVOIDED.

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2. SELDOM OR NEVER REFERRED TO BY THE GOVERNMENT OR PRESS ARE THE SEASONALLY ADJUSTED PRICE INDEX SERIES, WHICH GENERALLY PORTRAY A MUCH DIFFERENT PICTURE. IN THE ACCOMPANYING TABLES WE HAVE CALCULATED THE ANNUAL RATE OF PRICE INCREASE FOR THE TWO MONTH PERIOD ENDING IN THE MONTH INDICATED OVER THE PREVIOUS TWO MONTHS . (THIS AVOIDS THE EXTREME FLUCTUATIONS WHICH ONE MONTH DATA AT ANNUAL RATES TENDS TO SHOW AND THUS GIVES A BETTER PICTURE OF CURRENT TRENDS.) IN THIS CASE, INFLATION HAS BEEN ACCELERATING SO FAR THIS YEAR, RATHER THAN ABATING. WHILE THE YEAR-OVER-YEAR NON-ADJUSTED RATE OF INCREASE IN THE CONSUMER PRICE INDEX HAS DECLINED FROM 5.3 PERCENT IN JANUARY TO 4.5 PERCENT IN JUNE, THE SEASONALLY ADJUSTED ANNUAL RATE (S.A.A.R.) HAS RISEN FROM 2.8 PERCENT IN JANUARY TO 6.7 PERCENT IN MAY (SEE TABLE III). THE EMBASSY FEELS THAT THE LATTER (S.A.A.R.) MEASURE BETTER DEPICTS CURRENT PRICE TRENDS THAN THE FORMER, WHICH IS A VERY DECEPTIVE INDICATOR. FOR A GOVERNMENT INVOLVED IN A REELECTION EFFORT, OF COURSE, THE IMPROVEMENT IN THE YEAR-OVER-YEAR DATA PURPORTS TO SHOW IS USEFUL AND IT ALSO HELPS TO DAMPEN INFLATIONARY EXPECTATIONS AND WAGE DEMANDS. HOWEVER, IN FACT, CONSUMER PRICES ARE TRENDING UPWARDS AT AN ACCELERATING RATE. THE TRADE UNIONS HAVE ALLUDED TO THIS SITUATION AT THE RECENT "CONCERTED ACTION" (SEE REFTTEL) MEETING AND AWARENESS IN THE MORE INFORMED CIRCLES TO THE THREAT OF HIGHER INFLATION RATES IS GROWING.

3. INDUSTRIAL PRICES HAVE RISEN SHARPLY SINCE THE FIRST OF THE YEAR, WITH THE S.A.A.R. GOING FROM 2.6 PERCENT IN JANUARY TO 8 PERCENT IN MAY (SEE TABLE I). THE YEAR-OVER-YEAR PRICE RISE IS MUCH MORE MODERATE, WITH THE JANUARY RATE BEING 2.2 PERCENT, AND THAT FOR MAY BEING ONLY SLIGHTLY HIGHER AT 3.8 PERCENT. ONCE AGAIN, WE SEE THE CURRENT TREND MORE ACCURATELY REFLECTED IN THE S.A.A.R. FIGURE OF 8 PERCENT. IT WOULD APPEAR THAT INDUSTRY HAS NOT PAID HEED TO GOVERNMENT APPEALS TO RESTRAIN THEMSELVES ON THE PRICE FRONT (AND BY IMPLICATION DEPEND RATHER ON THE HEALTHY PROFIT MARGINS INHERENT

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IN THE CURRENT SITUATION OF RISING PRODUCTION IN A RELATIVELY LOW CAPACITY UTILIZATION POSITION). INTERESTINGLY, ECONOMICS MINISTRY STATE SECRETARY SCHLECT

ROSE TO THE DEFENSE OF BUSINESS AT A RECENT PRESS CONFERENCE BY STATING THAT INDUSTRIAL PRICES WERE INCREASING AT A DECLINING RATE, AND HE CITED MONTH-OVER-PREVIOUS-MONTH RATES FOR NON-SEASONALLY ADJUSTED DATA -- A VERY QUESTIONABLE ANALYTICAL APPROACH.

4. SO FAR IT HAS NOT BEEN THE COST OF IMPORTS THAT HAS FUELED THE INFLATIONARY TREND UNDER WAY -- CONTRARY TO THE ARGUMENT JUST PUT TO US BY THE CHIEF SHORT-TERM FORECASTER OF THE ECONOMICS MINISTRY. THE S.A.A.R INCREASE IN IMPORT PRICES IN JANUARY WAS UNDER 1 PERCENT, AND IN APRIL THEY WERE DECLINING AT A 20 PERCENT RATE. AN IMPORTANT FACTOR IN THIS DEVELOPMENT HAS BEEN THE APPROXIMATE 7 - 8 - PERCENT APPRECIATION OF THE DM SINCE THE FIRST OF THE YEAR, WHICH HAS OF COURSE LOWERED IMPORT COSTS ACCORDINGLY. A COROLLARY OF ALL THIS HAS BEEN THAT IN THE ABSENCE OF THE MODERATING EFFECT OF THE LOWERING OF IMPORT PRICES THAT HAS TAKEN PLACE, DOMESTIC PRICES WOULD HAVE RISEN EVEN MORE SHARPLY THAN THEY HAVE. ONCE MORE, THE POPULAR CONCEPTION OF IMPORT PRICE DEVELOPMENTS HAS BEEN OTHERWISE. LISTENING TO GOVERNMENT AND BUSINESS OPINION MAKERS, BLAME FOR UPWARD PRICE PRESSURES HAS BEEN ASCRIBED TO THE COST OF IMPORTS. AND, LOOKING AT THE YEAR-OVER-YEAR GROWTH RATE PUBLISHED BY THE BUNDESBANK (SEE SECOND COLUMN OF TABLE III), THE NEAR 8 PERCENT INCREASE INDICATED WOULD BACK THIS UP. HOWEVER, IN ADDITION TO THE GENERAL PROBLEM WITH THE USE OF YEAR-OVER-YEAR DATA TO DETERMINE CURRENT TRENDS NOTED EARLIER, IN THIS CASE THERE ALSO IS THE UNCERTAINTY OF THE DATA BASE. THE BUNDESBANK YEAR-OVER-YEAR SERIES DERIVES FROM A SURVEY OF A SAMPLING OF WHAT IMPORTERS SAY THEIR CONTRACTS INDICATE. ON THE OTHER HAND THE S.A.A.R. FIGURE (FIRST COLUMN OF TABLE III) AND THE FEDERAL STATISTICAL OFFICE SERIES UPON WHICH IT IS BASED (THIRD COLUMN OF TABLE III) ARE BASED ON ACTUAL SHIPMENTS AND THEREFORE ARE A MUCH MORE ACCURATE STATISTICAL INDICATOR.

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5. AS POINTED OUT ABOVE, WE HAVE IN OUR SEASONAL ADJUSTED FIGURES COMPARED THE LAST TWO MONTHS WITH THE

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PRECEDING ONE. WE BELIEVE THIS IS GENERALLY A MORE VALID COMPARISON THAN MONTH-TO-MONTH COMPARISONS AT ANNUAL RATES WHICH TEND TO MAGNIFY ACCIDENTAL MONTHLY SHIFTS TOO HEAVILY. THE BUNDESBANK AND THE FEDERAL GOVERNMENT SHARE THIS VIEW AND WHEN PRESENTING SEASONALLY ADJUSTED DATA, THEY DO SO ON A TWO MONTH COMPARISON BASIS. THEY DO NOT, HOWEVER, REPORT PRICES ON ANY OTHER THAN A YEAR-OVER-YEAR BASIS IN THEIR COMMENTARIES. IT SHOULD NONETHELESS BE POINTED OUT THAT ON A ONE MONTH COMPARISON, THE MAY SEASONALLY ADJUSTED DATA GENERALLY SHOW A LESSER RATE OF INCREASE THAN SHOWN IN APRIL, E.G., CONSUMER PRICES ROSE 8.6 PERCENT IN APRIL AND 6.0 PERCENT IN MAY. JUNE AND JULY DATA WILL SHOW WHETHER THIS WAS AN ABERRATION OF THE UNDERLYING TREND OR IF PRICE TRENDS WILL BE MODERATING. AN ECONOMICS MINISTRY CONTACT TOLD US HE EXPECTS NO MODERATION BECAUSE FOOD PRICES WILL BE UNDER STRONG DROUGHT-INDUCED UPWARD PRESSURE.

6. TABLES DETAILING THE FOREGOING ANALYSIS FOLLOW:

TABLE I

INDUSTRIAL PRICES - ANNUAL RATE OF INCREASE
(PERCENT)

SEASONALLY ADJUSTED 1/ NON-SEASONALLY ADJUSTED 2/
YEAR-OVER-YEAR RATE

1976

JAN.	2.6	2.2
FEB.	2.4	2.7
MAR.	3.5	3.2
APR.	5.5	3.5
MAY	8.0	3.8

TABLE II

CONSUMER PRICES - ANNUAL RATE OF INCREASE
(A PERCENT)

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SEASONALLY ADJUSTED 1/ NON-SEASONALLY ADJUSTED 2/
YEAR-OVER-YEAR RATE

1976

JAN.	2.8	5.3
FEB.	4.2	5.5
MAR.	4.8	5.4

APR.	5.4	5.2
MAY	6.7	5.0
JUNE		4.5

TABLE III

IMPORT PRICES - ANNUAL RATE OF INCREASE
(PERCENT)

SEASONALLY ADJUSTED 1/ SERIES I 2/	NON-SEASONALLY ADJUSTED SERIES II 3/	NON-SEASONALLY ADJUSTED
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	YR-OVER-YR RATE	YR-OVER-YR RATE	
1976			

JAN.	0.8	4.6	0.1
FEB.	-0.3	6.3	2.9
MAR.	-9.9	7.0	2.5
APR.	-19.9	7.7	3.1

1/ THE SEASONALLY ADJUSTED ANNUAL RATE IS CALCULATED AS THE PERCENT INCREASE IN THE INDEX NUMBERS FOR THE TWO-MONTH PERIOD ENDING IN THE MONTH STIPULATED OVER THE PRECEDING TWO-MONTH PERIOD, MULTIPLYING BY SIX TO GET THE ANNUAL RATE. SOURCE: UNDERLYING INDEX NUMBERS FROM BUNDESBANK, "REIHE 4, SAISONBEREINIGTE WIRTSCHAFTZAHLEN

2/ THE SOURCE FOR THE UNDERLYING INDEX NUMBERS IS THE BUNDESBANK "MONATSBERICHT".

3/ THE SOURCE FOR THE UNDERLYING INDEX NUMBERS IS THE FEDERAL STATISTICAL OFFICE PUBLICATION, "AUSSSENHANDEL REIHE 1, ZUSAMMENFASSENDE UBERSICHTEN".
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